

**Improvements Are Needed to Ensure That  
Employee Plans Return Information Is Timely  
Received and That Returns Are Properly  
Processed and Adequately Safeguarded**

**June 2002**

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**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 21, 2002

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Improvements Are Needed to Ensure That  
Employee Plans Return Information Is Timely Received and That  
Returns Are Properly Processed and Adequately Safeguarded  
(Audit # 200110012)

This report presents the results of our review of the centralization and processing of the Annual Return/Report of Employee Benefit Plan (Form 5500) returns. The overall objective of the review was to determine whether the Tax Exempt and Government Entities (TE/GE) Division effectively planned for and monitored the change in processing Employee Plans (EP) returns. In August 2000, the Department of Labor (DOL) started processing these returns, which had previously been processed by the Internal Revenue Service (IRS). The IRS relies on the EP return information to conduct examinations to determine whether employers and other plan sponsors are complying with the law.

In summary, we found that the IRS effectively planned for the centralization of processing the Form 5500 returns that needed additional action before they could post to the IRS' system prior to the July 1, 2001, implementation date. A transition plan was developed that identified the tasks to be completed and outlined the responsibilities of transition team members from the various IRS business units.

However, the IRS' efforts to monitor the implementation of the change in processing Form 5500 returns can be improved. For example, the DOL contractor experienced significant delays in processing Form 5500 returns in the first year of the contract and was at risk of not timely processing all of the returns. The IRS could have taken a more active role to determine the actual cause of the processing delays. In addition, the IRS still does not have access to the imaged Form 5500 returns, which is needed to correct error conditions and verify taxpayer information before corresponding with the taxpayer.

Moreover, the IRS has no assurance that existing controls effectively safeguard taxpayer remittances received by the DOL contractor or ensure that these remittances are timely and accurately processed. The IRS could not provide any records of the remittances received from the DOL contractor even though the DOL contractor's records showed that it had forwarded remittances totaling over \$1.8 million. In our limited test of these remittances, we determined that many of the remittances had not posted to the taxpayers' accounts. Finally, the computer systems used by the DOL contractor to process taxpayer information and by the IRS to view the Form 5500 returns have not been certified as meeting the Department of the Treasury's standards, which increases the risk of unauthorized use of taxpayer information.

We recommended that the Commissioner, TE/GE Division, reassess the terms of the interagency agreement with the DOL, including whether the 2001 and subsequent plan years' Form 5500 returns would be timely processed, and determine whether the IRS should consider other alternatives for processing these returns after the 5-year agreement has ended. Also, the telecommunication issues affecting access to the End User Access System should be resolved. In addition, the TE/GE Division should designate an office or individual to be responsible for conducting the safeguard reviews of the DOL contractor's site and coordinate with the DOL to ensure tax remittances and return information are properly safeguarded and timely processed. Furthermore, the IRS accreditation authority and the DOL should coordinate the certification effort for the computer systems used to process Form 5500 return information.

Management's Response: IRS management agreed with our recommendations cited in the report and is taking appropriate corrective action. Since the time of our review, TE/GE Division management has worked closely with the DOL to resolve the start-up problems, and stated that the DOL contractor has made substantial progress on processing returns within the time frames required by the contract. TE/GE Division management will compile an assessment report on the timeliness and completeness of 1999 and 2000 processing and will use this information to forecast the DOL's ability to timely process Form 5500 returns for 2001 and subsequent years.

The Modernization and Information Technology Service (MITS) is examining how to access the Form 5500 series returns and is determining whether alternative methods other than the End User Access System (EUAS) are appropriate. If EUAS is used, TE/GE Division management has determined the number of users that need access. The TE/GE Division management and the MITS will also coordinate and develop an implementation plan for IRS access to Form 5500 images that specifies the roles and responsibilities including security certification for the selected solution.

TE/GE Division management will work with the IRS' Office of Disclosure to perform safeguard reviews of the DOL contractor's site, which will increase assurances that controls are in place to safeguard taxpayer remittances received by the DOL contractor. In addition, the IRS Ogden Campus has agreed to report any discrepancies on transmittals from the DOL contractor to the TE/GE Division so that appropriate follow-up

actions can be initiated. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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### **Background**

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The Employee Retirement Income Security Act (ERISA), of 1974,<sup>1</sup> mandates that plan administrators and sponsors of employee benefit plans submit an Annual Return/Report of Employee Benefit Plan (Form 5500) to the Government. The Department of Labor (DOL) and the Internal Revenue Service (IRS) require employers and other plan sponsors, such as labor unions and trade associations, to report information concerning employee benefit and fringe benefit plans on the Form 5500. This information is used by four federal agencies<sup>2</sup> to carry out provisions of ERISA and other statutes applicable to their agencies. The IRS' Tax Exempt and Government Entities (TE/GE) Employee Plans (EP) Division uses the Form 5500 return information as part of its EP examination program to ensure that employers and other plan sponsors are complying with applicable provisions of the Internal Revenue Code (I.R.C.). If the employee benefit plan is a tax-exempt plan and it does not comply with legal provisions, the IRS can revoke its tax exempt status. The benefit plan becomes taxable and the employer or plan sponsor will be responsible for paying taxes retroactively to the first Form 5500 return filed for that plan.

In September 1996, the Congress recommended that the Pension and Welfare Benefits Administration (PWBA) of the DOL process the Form 5500 returns. In response to this action, the IRS and DOL established an interagency agreement on June 15, 2000, to share the costs of the system. Previously, the IRS was responsible for processing the Form 5500 returns.

In August 2000, a DOL contractor started processing the returns using the Employee Retirement Income Security Act of 1974 Filing Acceptance System (EFAST).<sup>3</sup> The EFAST is designed to electronically image the Forms 5500 and

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<sup>1</sup> 29 U.S.C. §6058 (1994 & Supp. V 2000).

<sup>2</sup> The four federal agencies are the DOL, the IRS, the Social Security Administration, and the Pension Benefit Guaranty Corporation.

<sup>3</sup> The EFAST is an automated system for accepting, processing, and storing Form 5500 returns.

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capture the information in a format that is compatible with the Employee Plans Master File (EPMF)<sup>4</sup> maintained by the IRS. The EPMF contains key information from the Form 5500 returns for all benefit plans filed by employers and sponsors. In those instances where information from the EFAST cannot be systemically posted to the EPMF, the IRS must connect to the End User Access System (EUAS) to view, search, and print electronic images of the returns to attempt to correct the return information so it can post to the EPMF.

During the period August 2000 to June 2001, the three IRS service centers that formerly processed the Form 5500 returns worked on correcting the returns that could not post to the EPMF. On July 1, 2001, the TE/GE Division centralized the responsibility for handling these returns that needed additional action to the Customer Account Services function at the Ogden Submission Processing Center (OSPC).

We performed our review at the IRS offices in Ogden, Utah; Washington, D.C.; and Memphis, Tennessee, and at the DOL contractor's facility in Lawrence, Kansas, between January and September 2001 and in February 2002. The audit was performed in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **Most Actions Were Taken to Centralize the Processing of the Form 5500 Returns at the Ogden Submission Processing Center**

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The IRS effectively planned for the centralization of processing the Form 5500 returns that need additional action before they can post to the EPMF prior to the July 1, 2001, implementation date. Examples of the planning efforts included:

- A transition team that consisted of employees from various IRS business units was assembled.

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<sup>4</sup> The EPMF is a database that maintains account information for employee plans.

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- A transition plan that identified specific tasks to be completed before the implementation date was developed.
- Team members were assigned various tasks and responsibilities.
- Bi-weekly meetings were held to discuss the status of outstanding issues or address new concerns.

As a result, most of the tasks in the transition plan were completed prior to the July 1, 2001, implementation date. For example:

- The OSPC hired and initiated training for most of the employees who will be assigned to work the Form 5500 returns.
- Procedures were developed for transferring the work to the OSPC.
- Guidelines for processing the work were revised.
- Computer programs were updated to generate the work at the new location.

The remaining tasks were not critical to successfully implementing the OSPC site, with the exception of access to the EUAS. Although the transition team timely submitted a Request for Information Services (RIS)<sup>5</sup> to obtain access to the EUAS, the RIS was not completed by the July 1, 2001, implementation date and, as of February 2002, the IRS still did not have access to the system. Further details on this issue are provided later in the report.

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### **The Internal Revenue Service's Actions Taken to Address Processing Delays May Not Ensure All Returns Will Be Processed Timely**

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The IRS could have taken additional actions to more timely address the various start-up problems that occurred when the DOL contractor began processing the Form 5500 returns. One issue involved delays by the DOL contractor in processing Form 5500 returns. Had IRS management taken a more active role to determine the actual cause of the processing delays rather than attributing the delays solely to

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<sup>5</sup> A RIS is the method the IRS uses to obtain information technology services.



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start-up problems experienced with a new system, the cause of the delays may have been identified sooner.

The DOL contractor will need to process about 1.2 million returns each year in order to meet the production rate that is necessary to consistently process its annual receipts. In order to meet this requirement, the IRS will need to receive approximately 23,000 returns each week. However, through December 31, 2001, the IRS had received only an average of about 14,660.

Start-up delays encountered by the DOL contractor shortened the actual processing period for the 1999 returns by seven weeks. As such, the DOL contractor provided the IRS with only 46 percent<sup>6</sup> of the returns filed for the 1999 plan year as of June 30, 2001. The DOL contractor increased the processing rate for the second processing year. Between July 1 and December 31, 2001, the DOL contractor averaged processing 17,972 returns per week, for a total of 467,280 returns. However, this increase may not be enough to ensure that IRS receives return information for the approximately 1.2 million returns that are received by the DOL contractor annually.

One of the factors contributing to the delays was that the DOL contractor received a significantly higher volume of handwritten returns than anticipated, which generally take longer to process.<sup>7</sup> According to the DOL contractor, about 15 percent of the handwritten returns processed through June 30, 2001, needed manual correction compared with less than 2 percent for computer-generated returns.

If the DOL contractor does not deliver the required services (e.g., does not meet the deadline of processing all the 1999 and 2000 plan year returns), the DOL contract stipulates a penalty of \$50,000 for non-performance, up to a maximum of \$200,000 in any single option period. In April 2001, IRS management recognized that the DOL

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<sup>6</sup> 546,353 returns processed divided by estimated receipts of 1.2 million.

<sup>7</sup> Handwritten returns generally take longer to process because they require more manual corrections and correspondence with taxpayers.

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contractor was not going to timely complete the processing of the 1999 plan year returns, and allocated additional funds for the DOL contractor to obtain additional equipment and resources. The IRS paid over \$2.9 million for additional equipment and resources during the first two years of the contract to address the backlog of returns and to assist the DOL contractor in improving the timeliness of processing. However, the IRS had no documentation of the expected improvements that should result from the additional funds. According to the contracting officer technical representative, the IRS can expect to continue paying the additional costs in each of the remaining three years of the contract.

Another issue that the IRS is faced with is that for 147,485 of the 1,140,340 (12.9 percent) Form 5500 returns processed by the DOL contractor for the 1999 and 2000 plan years through December 31, 2001, the IRS did not receive complete return information. The incomplete returns are considered “fact of file” records because they contain only basic tax information, such as the taxpayer’s name, identification number, and date the return was filed. However, this basic tax information does not assist the TE/GE Division in its efforts to assess compliance with the I.R.C.

IRS management advised us that the large number of “fact of file” records is primarily attributed to taxpayers who submit returns on the incorrect form, which cannot be processed by the EFAST system. However, beginning with the 2000 plan year returns, returns submitted on incorrect forms will be returned to the taxpayer for correction. This should reduce the number of “fact of file” records.

When both the delays in processing and incomplete return information are considered, the IRS received approximately 72 percent<sup>8</sup> of return data for the 1999 plan year needed to conduct studies for its examination program. Without a

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<sup>8</sup> The 1999 plan year returns processed less “fact of file” records divided by estimated volume (1,014,000 – 147,000 = 867,000/1.2 million = 72 percent).

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complete universe of returns, the IRS does not have reasonable assurance that samples used to conduct studies for its examination program are appropriately representative of the population of Form 5500 returns. Also, if the untimely processed Form 5500 returns are not included in the population of returns to examine, the IRS may not be aware of some potential areas of non-compliance if those returns do not comply with the law.

**Recommendations**

1. The Commissioner, TE/GE Division, should reassess the terms of the interagency agreement as soon as practical after June 30, 2002, based on the completeness and timeliness of the Form 5500 return information provided by the DOL for the 1999 and 2000 plan years. This assessment should include:
  - Whether the DOL will be able to timely process the 2001 and subsequent plan years' returns.
  - Whether additional engineering changes may be needed and the costs associated with the changes.
  - What impact the untimely processing of 1999 and 2000 plan year returns has had on the EP examination program's goals.

Management's Response: TE/GE Division management will compile an assessment report on the timeliness and completeness of 1999 and 2000 processing by October 1, 2003. TE/GE Division management will use this report to forecast the DOL's ability to timely process Form 5500 returns for 2001 and subsequent years. The assessment report will contain details of any needed engineering changes and associated costs.

2. Based on the reassessment, the Commissioner, TE/GE Division, should determine whether the IRS should consider other alternatives for processing Form 5500 returns after the 5-year interagency agreement with the DOL has ended.

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**The Internal Revenue Service  
Does Not Have Access to the  
Imaged Form 5500 Returns**

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Management's Response: TE/GE Division management will determine whether the IRS should consider other alternatives for processing Form 5500 returns after the 5-year interagency agreement with the DOL has ended, based on the assessment report on the timeliness and completeness of processing previous years' returns.

The interagency agreement with the DOL provides for access to the EUAS. However as of February 2002, TE/GE employees still do not have access to the system because the IRS needs to resolve telecommunication issues associated with transmission of data.

A RIS for the EUAS was signed April 24, 2000, requesting information technology support to address the problems with accessing return information. Since the RIS was prepared, the IRS has had several meetings with the DOL to discuss various issues but little progress has been made in obtaining access.

Because the EUAS is not available, TE/GE employees have to correct error conditions and verify taxpayer entity information without actually viewing the Form 5500 return. Instead, they have to attempt to correct the return information by researching the IRS' information system. However, this system may not have all the information needed to resolve inconsistencies between the EFAST and the EPMF. As a result, all inconsistencies may not be resolved and all correspondence with taxpayers cannot be verified for accuracy.

In addition to the above, we are concerned that when access to the EUAS becomes available, the number of users allocated to the IRS will not be sufficient to allow employees to perform their duties efficiently. The IRS did not perform an analysis to assess the number of users needing access to the imaged returns. Instead, the IRS and DOL met and arbitrarily arrived at 30 users needing access to the system. The DOL stated that it would be the IRS' responsibility to pay the costs associated with providing additional access to the EUAS.

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The IRS has 17 sites that will need access to the system and was allocated 30 accounts on the EUAS. However, only 10 IRS users can access the system simultaneously. The TE/GE analyst advised us that the OSPC operation alone would need access for about 30 users. In addition, EP examination employees and employees from Customer Account Services located throughout the country may need access to the imaged returns.

The current system is limited to 100 users and the IRS was allocated 30 accounts. Had the IRS performed an analysis to determine the appropriate number of users, the DOL may have been able to accommodate the IRS. However, it would now require a significant enhancement to the existing system to accommodate the additional IRS users.

**Recommendations**

3. The Commissioner, TE/GE Division, should coordinate with the IRS' Information Systems function, the DOL, and the DOL contractor to resolve the telecommunication issues affecting the access to the EUAS.

Management's Response: Modernization and Information Technology and Security Services (MITS) will present to the TE/GE Investment Executive Steering Committee a technical approach to access imaged Forms 5500, which will be consistent with all applicable telecommunications and security requirements.

4. The Commissioner, TE/GE Division, should determine the appropriate number of IRS users needing access to the EUAS and take actions to obtain access for these additional users.

Management's Response: TE/GE Division management has determined the number of users that should access the EUAS. Users will have access once the IRS resolves the technical issues.

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**The Internal Revenue Service Did  
Not Ensure Taxpayer  
Information Was Safeguarded or  
Tax Payments Were Properly  
Handled**

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At times, taxpayers send unrelated remittances and other documents to the DOL contractor, when submitting the Forms 5500, instead of sending them directly to the IRS. The DOL contractor is required to forward these misdirected remittances and documents to the Memphis Service Center (MSC) for processing. Records supplied by the DOL contractor showed that between October 2000 and May 2001, taxpayers sent 1,059 remittances, totaling more than \$1.8 million, to the DOL contractor. The DOL contractor informed us they forwarded these to the IRS for handling.

However, the IRS has no assurance that controls have been implemented to safeguard taxpayer remittances received by the DOL contractor or ensure that misdirected remittances are timely and accurately processed at the MSC. We observed that:

- The IRS could not provide any records of the 1,059 remittances forwarded by the DOL contractor.
- The TE/GE Division did not perform any site visitations at the DOL contractor facility to ensure that taxpayer information was properly safeguarded and that remittances were timely transmitted to the IRS.
- The TE/GE Division did not establish controls for processing misdirected remittances through a Service Level Agreement with the MSC.
- The Internal Revenue Manual (IRM) does not provide specific guidance for processing the misdirected remittances received from the DOL contractor.

In June 2001, we visited the DOL contractor's facility and observed a warehouse where approximately 1.2 million Form 5500 returns were stacked from the floor to the ceiling. The DOL contractor advised us that over 200,000 of the 1.2 million returns only had the envelopes sliced opened and were waiting to be processed. These unprocessed returns may have included checks and cash with the Form 5500 returns.

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We also observed that DOL contractor employees had no restrictions regarding the possession of personal items within the processing facility. Several employees had purses and other personal items at their workstations. In addition, the two employees responsible for opening the mail were separated from the other employees and managers. Each of these observations represents a control weakness, which increases the risk of lost or stolen remittances because DOL contractor employees have the opportunity to take remittances without being detected.

The IRS is permitted to conduct safeguard reviews by visiting the DOL contractor's facility on a regular basis. However, the IRS did not conduct any reviews because the responsible IRS manager was unaware of the provision. The visitations would have provided the IRS with the opportunity to identify potential control weaknesses and to discuss changes that would ensure the DOL contractor was adequately protecting remittances and timely transmitting them to the IRS.

The IRS is responsible for ensuring that effective cash management practices are present. This includes ensuring that all monies are appropriately safeguarded, accurately accounted for, and timely deposited.

To test whether the misdirected remittances were posted to taxpayers' accounts, we selected a random sample of 218 remittances from the 1,059 remittances listed on the DOL contractor's remittance log as of May 23, 2001. Our review of the 218 remittances showed that, as of July 11, 2001, only 77 (35 percent) of the remittances had been posted to taxpayers' accounts. The IRS had no records to confirm receipt of the remaining 141 cases. However, IRS managers at the MSC advised us that some of the remittances received from the DOL contractor may not have been processed by the IRS because they were made payable to either a private individual, a private company, or the PWBA. The IRS processes only those remittances made payable to the IRS or the Department of the Treasury. Regardless of who the checks were made payable to, the IRS could not provide any documentation showing the

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disposition of remittances that did not post to taxpayer accounts. As a result, we could not determine if the IRS had forwarded these remittances to the proper agency or returned them to the taxpayer.

These cases will be referred to the Treasury Inspector General for Tax Administration's Office of Investigation for further action.

The IRS also did not ensure that remittances were timely posted to taxpayer accounts. For the 77 remittances that posted, we identified 43 (56 percent) instances where it took more than 30 days between the dates the DOL contractor indicated the remittances were sent to the IRS and the date the payments posted to the taxpayers' accounts. As a result of the delays, the IRS generated erroneous delinquency notices to 19 of the 77 taxpayers.

Although the IRS had some delays in posting payments to taxpayers' accounts, the primary delays occurred because the DOL contractor did not process the remittances immediately upon receipt. If the DOL contractor receives returns prior to the beginning of the new filing period, the envelopes are opened but then held in the DOL contractor's warehouse until the next processing cycle. If any of these envelopes contained misdirected remittances, the DOL contractor would not know that until it started processing the returns. For example, if the DOL contractor received Plan Year 2000 returns (containing misdirected remittances) in February 2001, the remittances would be held until the DOL contractor started processing the next cycle of returns on July 1, 2001. Delays in transmitting remittances to the IRS increase the risk of theft and increase the burden on taxpayers if the IRS sends delinquency notices and the taxpayer had already paid the tax.

### **Recommendations**

5. The Commissioner, TE/GE Division, should designate an office or individual to be responsible for conducting the safeguard reviews of the DOL contractor's site.



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Management's Response: TE/GE Division management has consulted with the Director, Office of Disclosure, and will schedule a safeguard review during Fiscal Year 2003.

6. The Commissioner, TE/GE Division, should coordinate with the DOL to implement existing processing controls to ensure tax remittances and return information are timely processed and properly safeguarded by the DOL contractor. For example, time frames in which the DOL contractor must send remittances to the IRS should be enforced and additional controls to protect the physical security of the remittances at the DOL contractor site should be established.

Management's Response: The safeguard review will include an evaluation of the physical security of remittances at the DOL contractor site.

7. The Commissioner, TE/GE Division, should revise the IRM to include processing guidelines regarding the receipt of misdirected remittances from the DOL contractor.

Management's Response: TE/GE Division management has revised the instructions to the 2001 5500 series returns to instruct filers not to submit a remittance with returns. TE/GE Division management has also modified the processing guidelines to ensure proper and timely processing of mail and remittances from the DOL contractor. The IRS Ogden Campus has agreed to report to the TE/GE Division any discrepancies on transmittals from the DOL contractor so TE/GE management can initiate appropriate follow-up actions.

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**The Internal Revenue Service  
Could Have Taken More Timely  
Action to Ensure Computer  
Systems That Process Taxpayer  
Information Are Certified**

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The DOL contractor's system used to process the Form 5500 returns is not certified as meeting the IRS security requirements. Neither the EFAST system nor the EUAS systems have been certified to meet the Department of the Treasury's standards. Such certification is required of all systems processing IRS data and is the standard that the DOL agreed to in the interagency agreement. Information systems that are not appropriately certified and accredited

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increase the risk of unauthorized use of the taxpayer information maintained on these systems.

An official from the DOL advised us that the EFAST and EUAS systems were not accredited and certified prior to being placed in service because the DOL has been focused on the start-up of the DOL contractor facility. The DOL initially granted the DOL contractor an interim authority to operate the systems through June 30, 2001. The DOL subsequently extended the DOL contractor's authority through August 24, 2001.

Better and more timely communication and coordination among the TE/GE functional executives, the IRS Certification Program Office, and the DOL is needed to achieve accreditation and certification of the EFAST and EUAS systems. For example, in September 2000, the DOL sent a memorandum to the IRS requesting feedback on 26 security weaknesses identified by the DOL. Instead of directly addressing each of the 26 issues outlined in the memorandum or preparing a formal response to the memorandum, the IRS provided the DOL an e-mail message requesting that the DOL contractor prepare a risk migration plan. On July 27, 2001, after several meetings between the IRS and DOL, the IRS advised the DOL that they would pay additional funds of \$413,871 for the DOL contractor to prepare the risk migration plan, physical security upgrades, and security clearances. This 10-month delay in responding to the DOL contractor's September 2000 memorandum extends the time before the two systems can be certified and continues to put taxpayer information at risk.

### **Recommendation**

8. The Commissioner, TE/GE Division, should ensure that the IRS accreditation authority and the DOL are coordinating the certification effort prior to submitting certification packages to the Certification Program Office.

Management's Response: TE/GE Division management and MITS will coordinate and develop an implementation

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plan for IRS access to Form 5500 images that specifies the roles and responsibilities, including security certification for the selected solution.

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**Appendix I**

**Detailed Objective, Scope, and Methodology**

The objective of the review was to determine whether the Tax Exempt and Government Entities (TE/GE) Division effectively planned for and monitored the change in processing Employee Plans (EP) returns. To accomplish our objective, we performed the following audit tests:

- I. Evaluated the effectiveness of Internal Revenue Service (IRS) management's oversight to implement the EP returns processing. Specifically, we reviewed the EP transition plan for transferring the EP operations to the Ogden Submission Processing Center (OSPC).
  - A. Determined whether the plan clearly defined the responsibilities of the individuals and business functions for transferring, implementing, and processing the EP work at the OSPC.
  - B. Determined whether the Tax Exempt and Government Entities (TE/GE) Division established service level agreements with other business functions and established methods to track performance and compliance with these agreements for residual<sup>1</sup> processing of the EP returns.
  - C. Determined whether management identified and obtained the appropriate resources to timely implement or timely process the additional work.
  - D. Determined whether management developed alternatives in the event that the OSPC did not obtain the necessary resources.
  - E. Determined the status of updating the codebooks, Internal Revenue Manuals, training material, and procedural changes related to the transfer.
  - F. Determined whether operating procedures for implementing the transfer were developed.
  - G. Identified other initiatives planned for additional work at the OSPC and determined whether these initiatives would affect the residual processing of the EP returns.
  - H. Determined whether management identified any risks (schedule, technical, operational, and programmatic) and evaluated the method used to resolve the risks.
- II. Determined whether system changes were required and whether the changes were completed timely.
  - A. Determined whether Requests for Information Services were appropriately processed.

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<sup>1</sup> Returns that need correcting because they could not be validated with IRS information.

**Improvements Are Needed to Ensure That Employee Plans  
Return Information Is Timely Received and That Returns  
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- B. Determined whether the TE/GE Division identified systems and networks requiring security certification and whether the systems and networks were timely and appropriately certified/recertified and accredited.
  - C. Interviewed appropriate analysts.
    - 1. Determined whether systems and network additions or changes were designed with appropriate security.
    - 2. Determined whether system changes were tracked and recertified.
  - D. Interviewed the IRS Certification Office analyst and identified the certification requirements and status of systems and networks used by the OSPC for the EP workload migration.
- III. Evaluated whether the Department of Labor's (DOL) processing of the Annual Return/Report of Employee Benefit Plan (Form 5500) returns affected IRS operations.
- A. Determined whether the DOL provided the IRS with required data regarding Forms 5500, such as the entity changes generated by the Employee Retirement Income Security Act of 1974 Filing Acceptance system (EFAST)<sup>2</sup> used to update the Employee Plans Masterfile (EPMF)<sup>3</sup> and whether any delays affected the IRS.
  - B. Reviewed the interagency agreement with the DOL and determined whether the TE/GE Division established methods to track performance and compliance with the agreement.
  - C. Reviewed the process the OSPC has implemented to ensure that the EFAST weekly transaction files received from the DOL accurately post to the EPMF.
  - D. Contacted the Memphis Service Center (MSC) and determined whether the DOL processing of Forms 5500 or the transition to the OSPC had affected the MSC.
  - E. Reviewed a random number sample<sup>4</sup> of 218 remittances sent from the DOL contractor to the MSC and determined whether the payments posted to the taxpayers account.

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<sup>2</sup> The EFAST is the automated system for accepting, processing, and storing Forms 5500.

<sup>3</sup> The EPMF is the TE/GE database that maintains the employee plan taxpayer account information.

<sup>4</sup> See Appendix V for the Detailed Sampling Plan.

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**Appendix II**

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**Appendix III**

**Report Distribution List**

Commissioner N:C

Deputy Commissioner Operations N:D C

Commissioner, Small Business/Self-Employed Division S

Deputy Commissioner, Small Business/Self-Employed Division S

Deputy Commissioner, Tax Exempt and Government Entities Division T

Director, Submission Processing Center, Ogden S:CAS:SP:O

Chief Counsel CC

National Taxpayer Advocate TA

Director, Legislative Affairs CL:LA

Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O

Office of Management Controls N:CFO:F:M

Audit Liaison:

Director, Communications and Liaison, Tax Exempt and Government Entities  
Division T:CL

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**Appendix IV**

**Outcome Measures**

This appendix presents detailed information on the measurable affect that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Privacy and Security - Actual, we estimated that 688 remittances could not be accounted for (see page 9).

Methodology Used to Measure the Reported Benefit:

From our statistical sample of 218 remittances from a population of 1,059 remittances received by the Department of Labor contractor between October 2000 and May 2001 and forwarded to the IRS, we determined that 64.7 percent ( $\pm$  4.8 percent) of the remittances did not post to taxpayers accounts. This figure is calculated based on the following:

$1,059 \text{ remittances} * (64.7 \text{ percent} \pm 4.8 \text{ percent}) = \text{the range of 634 and 736 (see Appendix V).}$

The mid-point of the range is 688 ( $1,059 \text{ remittances} * 64.7 \text{ percent} = 688 \text{ remittances}$ ).

Type and Value of Outcome Measure:

- Taxpayer Burden – Actual, 19 erroneous notices sent to taxpayers (see page 9).

Methodology Used to Measure the Reported Benefit:

We used the 19 erroneous notices that were sent to taxpayers because the IRS did not timely post remittances to the taxpayers' accounts.



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**Appendix V**

**Detailed Sampling Plan**

**Overall Sample Criteria -**

<b>Type of Sample:</b>	Attribute
<b>Confidence Level:</b>	90%
<b>Desired Precision Rate:</b>	+/-5%
<b>Expected Rate of Occurrence:</b>	Not to exceed 50%
<b>Formula Used to Calculate Initial Sample Size:</b>	$n = p(1-p)SE/t^2 + p(1-p)/N$ <p> n = sample size = 218  p = expected rate of occurrence = .50  SE = desired precision = 5  t = confidence level factor = 1.65  N = audit universe = 1059 </p>

**Calculating Sampling Error -**

Where all numbers are rounded to tenths	
<b>Confidence Level:</b>	90%
<b>Rate of Occurrence:</b>	64.7%
<b>Sampling Error Rate Calculation:</b>	$SE = \pm t \cdot (\sqrt{p(1-p)/n}) \cdot (\sqrt{1-n/N})$ <p>where:</p> <p> t = confidence level factor = 1.65  p = actual error rate = 64.7%  n = sample size = 218  N = audit universe = 1,059  SE = actual precision = <math>\pm 4.8\%</math> </p>
<b>Formula to calculate the upper and lower confidence interval limits:</b>	<p>where:</p> <p> p = actual error rate = 64.7%  SE = actual precision = <math>\pm 4.8\%</math>  lower limit = (p-SE) = 59.9%  upper limit = (p+SE) = 69.5% </p>

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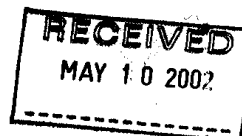
Appendix VI

**Management's Response to the Draft Report**




DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

MAY - 9 2002



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Evelyn A. Petschek, Commissioner   
Tax Exempt and Government Entities Division

SUBJECT: Management Response to Draft Audit Report 2001-10-012: Improvements Are Needed to Ensure That Employee Plans Return Information Is Timely Received and That Returns Are Properly Processed and Adequately Safeguarded

I have reviewed your draft report on the way the Internal Revenue Service planned for and monitored the transfer of the processing of Form 5500 returns from the Internal Revenue Service to the Department of Labor (DOL).

I appreciate your observation that the IRS planned the centralization of the processing of the Form 5500 returns effectively. I also appreciate your suggestions about how we might best monitor the way DOL and its contractor implement the processing of the Form 5500s under the new system. I should note five observations on the report:

1. The data you based some of the recommendations on has changed since your review, and no longer reflects the way the program is working. For example, the timeliness of the return processing operation has significantly improved. As a result, we believe drawing firm conclusions about a 5-year contract based upon start-up problems is premature.
2. The actual filings of 1999 Forms 5500 are less than anticipated. We therefore have lowered our projections for total filings for the 1999 return year from 1.2 million to 1.05 million. Based on this change, it appears that DOL's contractor has processed 98% of the total returns as of March 31, 2002.
3. The EFAST processing system is designed to fully process filings for a given plan year over the course of two processing years starting on July 1<sup>st</sup> of each year. Therefore, the DOL's contractor has until June 30, 2002,

## **Improvements Are Needed to Ensure That Employee Plans Return Information Is Timely Received and That Returns Are Properly Processed and Adequately Safeguarded**

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to process Forms 5500 for the 1999 plan year and until June 30, 2003 to process the 2000 plan year returns.

4. The Form 5500 series returns are "information returns", not tax returns. Although there are no circumstances or conditions calling for remittances to be filed with these returns, some filers erroneously included remittances.
5. On page 8 of the report, you state that the DOL forward returns and remittances to the Memphis Service Center. The DOL now forwards these returns and remittances to the Ogden Submission Processing Center.

Our comments on the specific recommendations in the report are as follows:

### **Recommendation 1:**

The Commissioner, TE/GE Division, should reassess the terms of the interagency agreement as soon as practical after June 30, 2002, based on the completeness and timeliness of the Form 5500 return information provided by the DOL for the 1999 and 2000 plan years. This assessment should include:

- Whether the DOL will be able to timely process the 2001 and subsequent plan years' returns.
- Whether additional engineering changes may be needed and the costs associated with the changes.
- What impact the untimely processing of 1999 and 2000 plan years returns has had on the EP examination program's goals.

### **Assessment of Cause:**

The TIGTA found, at the time of its review, start-up problems were threatening to delay the processing of returns for plan years 1999 and 2000.

Since that time, we have worked closely with DOL to resolve the start-up problems, and the contractor has made substantial progress on processing returns within the timeframes required by the contract.

### **Corrective Action:**

By October 1, 2003, we will compile an assessment report on the timeliness and completeness of 1999 and 2000 processing. We will use this report to forecast

## **Improvements Are Needed to Ensure That Employee Plans Return Information Is Timely Received and That Returns Are Properly Processed and Adequately Safeguarded**

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DOL's ability to timely process Form 5500 returns for 2001 and subsequent years. The assessment report will contain details of any needed engineering changes and associated costs.

**Implementation Date:** October 1, 2003

**Responsible Officials:** Director, Employee Plans (EP) T:E  
Director, Business Systems Planning T:BSP

**Corrective Action Monitoring Plan:**

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

**Recommendation 2:**

Based on the reassessment, the Commissioner, TE/GE Division, should determine whether the IRS should consider other alternatives for processing Form 5500 returns after the 5-year interagency agreement with the DOL has ended.

**Assessment of Cause:** Not applicable

**Corrective Action:**

Based on the assessment report on the timeliness and completeness of processing previous years' returns, the Directors EP and BSP will determine whether the IRS should consider other alternatives for processing Form 5500 returns after the 5-year interagency agreement with the DOL has ended.

**Implementation Date:** November 1, 2003

**Responsible Officials:** Director, Employee Plans T:E  
Director, Business Systems Planning T:BSP

**Corrective Action Monitoring Plan:**

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

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### **Recommendations 3:**

The Commissioner, TE/GE Division, should coordinate with the IRS' Information Systems function (ITS), the DOL, and the DOL contractor to resolve the telecommunication issues affecting the access to the EUAS.

### **Assessment of Cause:**

The TIGTA found that, as of February 2002, TE/GE employees do not have access to the EUAS system because the IRS needs to resolve telecommunication issues associated with the transmission of data.

Modernization and Information Technology and Security Services (MITS) is examining, from a technical point of view, how the IRS will access imaged 5500 series returns. MITS also is determining alternative methods, other than EUAS, by which the IRS may access imaged Form 5500 returns. As part of this effort, we have prepared a report titled "Alternative Analysis for IRS End-User Online Access to Form 5500 Series Filing".

### **Corrective Action:**

MITS will present to the TE/GE Investment Executive Steering Committee a technical approach -- consistent with all applicable telecommunications and security requirements -- to access imaged Forms 5500, under RIS EMP-0-0005.

**Implementation Date:** July 1, 2003

**Responsible Officials:** TE/GE Division Information Officer

### **Corrective Action Monitoring Plan:**

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

### **Recommendation 4:**

The Commissioner, TE/GE Division, should determine the appropriate number of IRS users needing access to the EUAS and take actions to obtain access for these additional users.

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### **Assessment of Cause(s):**

The TIGTA found, at the time of its review, that we had 17 sites that would need access to the EUAS system and would have 30 accounts on the EUAS system. However, we had not yet determined what an adequate number of accounts would be.

Since the time of the review, the Director, Employee Plans, has determined the number of users that should access EUAS. Users will have access once we resolve the technical issues referred to in Recommendation 3.

**Corrective Action:** Completed.

**Implementation Date:** Completed.

**Responsible Official:** Not applicable.

**Corrective Action Monitoring Plan:** Completed.

### **Recommendation 5:**

The Commissioner, TE/GE Division, should designate an office or individual to be responsible for conducting the safeguard reviews of the DOL contractor's site.

### **Assessment of Cause(s):**

Our contract allows us to conduct safeguard reviews by visiting the contractor's facility on a regular basis, but we have not yet done so.

### **Corrective Actions:**

IRC §6103(n) and the contract allow the Director, Office of Disclosure (CL:GLD:D), to perform a safeguard review. TE/GE has consulted with the Director, Office of Disclosure, and will schedule a safeguard review during FY 2003.

**Implementation Date:** October 1, 2003

**Responsible Official:** Director, Employee Plans (T:E), with the assistance of the Office of Disclosure

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### **Corrective Action Monitoring Plan:**

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

### **Recommendation 6:**

The Commissioner, TE/GE Division should coordinate with the DOL to implement existing processing controls to ensure tax remittances and return information are timely processed and properly safeguarded by the DOL contractor. For example, time frames in which the DOL contractor must send remittances to the IRS should be enforced and additional controls to protect the physical security of the remittances at the DOL contractor site should be established.

### **Assessment of Cause:**

The TIGTA found, at the time of the review, that the IRS had no assurances that controls were in place to safeguard taxpayer remittances received by the DOL contractor or to ensure that they process misdirected remittances timely and accurately. Since then, we have taken action to provide that assurance:

- We have modified the instructions to the 2001 5500 series returns to instruct filers not to submit a remittance with returns
- We have modified IRM 3.10.72 (Service Center Mail and Work Control) and IRM 3.8.45 (Manual Deposit) to ensure proper and timely processing of mail and remittances from the DOL vendor.
- The SB/SE Ogden Campus has agreed to report any discrepancies on transmittals from the DOL vendor to TE/GE so that we can initiate appropriate follow-up actions.

### **Corrective Actions:**

The safeguard review (see Recommendation 5) will include an evaluation of the physical security of remittances at the DOL contractor.

**Implementation Date:** October 1, 2003

**Responsible Officials:** Director, Employee Plans, with the assistance of the Office of Disclosure and the MITS Office of Security Policy Support and Oversight

**Corrective Action Monitoring Plan:** We will monitor this corrective item through the Business Performance Review Process of the Commissioner of

## **Improvements Are Needed to Ensure That Employee Plans Return Information Is Timely Received and That Returns Are Properly Processed and Adequately Safeguarded**

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Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

### **Recommendation 7:**

The Commissioner, TE/GE Division should revise the Internal Revenue Manual to include processing guidelines regarding the receipt of misdirected remittances from the DOL contractor.

#### **Assessment of Causes:**

The TIGTA found, at the time of the review, that the IRS had no assurances that controls were implemented to safeguard taxpayer remittances received by the DOL contractor or to ensure that misdirected remittances were timely and accurately processed. Since then, we have taken the actions identified in the three bullets under Assessment of Causes at Recommendation 6 above. These actions satisfy Recommendation 7.

**Corrective Action:** Completed.

**Implementation Date:** Completed.

**Responsible Officials:** Not applicable.

**Corrective Action Monitoring Plan:** Completed.

### **Recommendation 8:**

The Commissioner, TE/GE Division, should ensure that the IRS accreditation authority and the DOL are coordinating the certification effort prior to submitting certification packages to the Certification Program Office.

#### **Assessment of Causes:**

The DOL contractor's system used to process the Form 5500 returns is not certified as meeting the government security requirements.

#### **Corrective Action:**

TE/GE and MITS will coordinate and develop an implementation plan for IRS access to Form 5500 images that specifies the roles and responsibilities, including security certification for the selected solution.



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**Implementation Date:** July 1, 2003

**Responsible Official:** TE/GE Division Information Officer

**Corrective Action Monitoring Plan:**

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Inventory Tracking and Closure system of the Treasury Department.

The TIGTA has included in its report an estimate of measurable tax administration benefits that it believes will flow from the report and its recommendations. We do not question TIGTA's estimates in this regard, and accept them.

If you have any questions, please contact Rick Westley at (202) 283-9513.